STATE OF CALIFORNIA
CONSUMER POWER AND CONSERVATION FINANCING AUTHORITY

INITIAL COMMENTS OF INDEPENDENT ENERGY PRODUCERS ASSOCIATION

ON THE DRAFT

ENERGY RESOURCE INVESTMENT PLAN

(STAFF WORKING DRAFT OF JANUARY 18, 2002)

OF THE CALIFORNIA CONSUMER POWER AND

CONSERVATION FINANCING AUTHORITY

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At the invitation of the California Power Authority (CPA) the Independent Energy Producers Association (IEP) provides these initial comments on the Draft Energy Resource Investment Plan ("Staff Draft"). IEP is using these initial comments to identify key areas of interest in the Staff Draft. IEP looks forward to working with the CPA on the development of the CPA's Energy Resource Investment Plan.

Interest Area 1: Coordination with the California Public Utilities Commission

The California Public Utilities Commission (CPUC) has commenced and placed on a fast-track an Order Instituting Rulemaking (OIR) to Establish Policies and Cost Recovery Mechanisms for Generation Procurement and Renewable Resource Development.[1] The purpose of the OIR is to reposition the investor-owned utilities to reassume their position in electric power procurement. The CPA, as well as IEP, is an active participant in the OIR, even at the threshold level of law and motion regarding protective orders.

IEP's question is whether the CPA intends for a final energy resource investment plan to feed into the CPUC's process as evidence to be considered there, or whether it perceives its plan as an independent resource procurement mechanism? This is an issue of enormous import. If the CPA perceives its plan as a procurement mechanism independent of the CPUC's efforts it will certainly confound rather than be a work in "lockstep" with the CPUC as suggested in the Staff Draft (at 4). The CPUC's OIR will address procurement standards (including reserve margins and resource diversity obligations for renewables), cost recovery mechanisms and standards of reasonableness with respect to cost.[2] IEP does not understand how the utilities could execute a procurement plan approved under the auspices of the OIR concurrently with an

[1] OIR 01-10-024
[2] See, R.01-10-024 January 8, 2002 PHC transcript at 3.

independent, parallel, CPA procurement program and have any assurance that they were meeting their obligations with respect to those standards.

Interest Area 2: Factors Affecting Uncertainty in Future Supply of Electricity (p. 9)

The Staff Draft alludes to a number of factors creating uncertainty in the future supply of electricity. Most of these factors relate to the availability of independent, private power producers in the future. For example, the Staff Draft notes that private, unregulated generating facilities can build or fail to build plants as they choose; that generating companies have the legal right to sell out of state; and that generators may spend as little as they want on maintenance.[3] In addition, the Staff Draft states that suppliers have no responsibility to have any reserves at all.

These conditions are not inherent characteristics of independent power producers; each and all could as easily apply to unregulated private power plants, regulated power plants, or public power plants. What resolves uncertainty associated with these factors is the use of contractual vehicles between suppliers and buyers. Throughout the nation, and in California, independent power producers have a long history of executing and honoring bilateral contracts specifically designed to mitigate the uncertainty factors listed in the Staff Draft. The use of a combination of short-, intermediate- and long-term contracts with performance guarantees exchanged for price guarantees would be at least as effective in this regard as any "regulatory compact" as might be associated with reliance on fully regulated entities.

[3] IEP is uncertain as to the point of this latter observation. While prescripted maintenance expenditures *per se* may be untypical, generators have natural incentives to invest in prudent maintenance practices in order to maintain reliability and availability; maintenance standards are also typically conditions of power purchase agreements, participating generator agreements and applicable tariffs. See also, Article 5.4 et seq of the California Independent System Operator Conformed Tariff.

With regard to the observation that "suppliers have no responsibility to have any reserves at all,"[4] IEP notes that (1) typically (and more properly) maintenance of reserve margins is a responsibility and function of load serving entities rather than individual generators, as the reserves are directly correlated to specific load requirements, but (2) having said that, generators can provide capacity reserves as long as there is a capacity component in the market or contractual mechanism with a creditworthy counterparty to the arrangement.

Interest Area 3: CPA Role in Marketplace: "Financier" vs. Owner/Operator

The Staff Draft suggests a role for the CPA in the marketplace as one of owner/operator of generation facilities. The Staff Draft goes so far as to suggest that the CPA utilize eminent domain to take over existing facilities and/or its bond authorities to finance, build, own, and operate new facilities. Either proposal would, if implemented, chill project development and invite potentially disastrous supply/demand imbalances, instability and impaired system reliability. As noted in a panel discussion on investor behavior at a workshop convened by the California Energy Commission on November 7, 2001, "Exploring Alternative Wholesale Energy Market Structures of California," Professor Andy Ford remarked as follows:

> …when the western market is simulated over a longer time interval, it becomes clear that the Power Authority commitments will eventually lead to a reduction in private sector investment. ("Simulation Scenarios for the Western Electricity Market," prepared by Professor Andrew Ford, Washington State University, p. 24).

IEP agrees with Professor Ford that the intervention of the CPA, particularly in an owner/operator mode, will tend to drive away much needed private investment in California. Alternatively, IEP does believe that the CPA can provide a valuable service by assisting in the financing of new generation facilities, particularly renewable energy facilities or conventional

[4] Staff Draft at 9.

facilities which may be comparatively difficult to site and develop. As the state, particularly the CPUC, moves to impose a renewable purchase obligation on load serving entities in order to provide resource diversity and reliability benefits, the CPA could provide a significant incentive to this program by assisting in buying down the financial costs of private developers who have the expertise and historical experience in developing renewable energy projects. Similarly, the CPA could assist in brokering or packaging energy products to meet specific needs such as a state agency renewable purchase requirement.

Interest Area 4: The role of conventional plant modernization

Private companies have already invested hundreds of millions of dollars into the construction of new generation and the modernization of fossil-fueled power plants acquired from the IOUs in the restructuring transition. These latter plants are generally aged and inefficient in comparison with state of the art facilities and have comparatively high emissions – some rely on dual-fuel (natural gas and fuel oil) capability. These companies are poised to invest hundreds of millions more dollars to complete the modernization process, eliminating the use of fuel oil, increasing generating capacity with far higher efficiencies, lower emissions and other environmental impacts.

If IEP is reading the Staff Draft (at 4) correctly, at least in the intermediate term (through 2006) the proposal is to meet all of California's projected load growth capacity needs of about 8000 MW with a combination of efficiency, load management, distributed generation and renewable resources. IEP's question is whether the CPA is proposing that plant modernization projects be terminated? This issue is also of great import. If the modernizations are not pursued California will be foregoing an infusion of potentially hundreds of millions of dollars in new capital investment and the Staff Draft's estimated 8000 MW of new capacity, which only addresses load growth, is insufficient to avoid capacity shortfalls.

Interest Area 5: Capacity Reserve Standards versus Prescriptions

IEP is in accord with the Staff Draft that a clear and compulsory standard should exist for load serving entities, as a matter of California state policy, on capacity reserves both on an installed and operational basis. As noted, the CPUC is now considering the reserve margin, renewable obligation, cost recovery and review mechanisms that will direct the IOUs' procurement strategies going forward. Provided with appropriate ground rules and expectations, IEP is unaware of any reason to believe that the utilities are not fully capable of implementing adopted standards. There is no reason apparent to IEP for the Staff Draft's leap to the view that the CPA is somehow uniquely positioned to see to the accomplishment of procurement standards once adopted.

IEP is in accord with the Staff Draft that diversity should be subsumed within any such standards. The Staff Draft, however, inadequately recognizes that the value of diversity, however, is multi-faceted as IEP pointed out in comments on the OIR:

> Policies in this area should be based upon the touchstone of portfolios that are diverse with respect to commitment, technology and fuel. Diversity is important because it helps manage risks of production or delivery, and because it is the basis of achieving supplies at the lowest, stable prices for a portfolio of power delivered to consumers. Diversity should be thought of in three distinct ways:
>
> **(1) Temporal diversity**, meaning that there should be a mix of resources of varying terms or periods;
>
> **(2) Product diversity**, meaning achieved through a mix of different energy, ancillary services and other capacity products (including both "standard" and "non-standard" products **sufficient** to meet loads, including operating reserves and "planning" reserves needed to avoid supply shortfalls) as well

as risk management products such as financial hedge instruments; and,

(3) **Resource / fuel diversity**, meaning that there should be a mix of **supply** resources aimed at mitigating exposure to supply or input price shocks.[5]

While IEP supports demand reduction and renewable energy development in the range suggested in the Staff Draft; complete reliance on those resources is perilous. By its own reckoning the Staff Draft (at 8) recognizes the fleeting and uncertain impact of conservation measures and the impact of such measures is difficult to measure or forecast. A valid, sustainable resource procurement plan should recognize the role of all resource opportunities, across multiple product descriptions and acquired through short-, intermediate- and long-term contractual vehicles, and create an opportunity for competition within all such options.

IEP thanks the CPA for consideration of these initial comments and looks forward to further discussions. Refocusing attention on a potential role of the CPA as a provider of financial support, rather than as an alternate or substitute procurement entity could provide significant benefits and tend not to distract efforts to reinstall IOUs as procurement agents of private supply and demand-reducing resources.

Respectfully submitted,

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[5] IEP Initial Comments in R.01-10-024 at 7.